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In the Supreme Court of the United States

OCTOBER TERM, 1972

No. 71-1621

ESTATE OF LAFAYETTE MONTGOMERY, DECEASED, TRUST COMPANY OF GEORGIA, ARTHUR L. MONTGOMERY AND GEORGE A. MONTGOMERY, EXECUTORS, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 136-152) [1] is reported at 56 T.C. 489. The opinion of the court of appeals (Pet. 1a-6a) is reported at 458 F. 2d 616.

[1] "R." references are to the record appendix filed in the court of appeals.

JURISDICTION

The judgment of the court of appeals was entered on April 18, 1972. (Pet. 7a-8a.) The petition for a writ of certiorari was filed on June 14, 1972. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the proceeds of certain life insurance policies taken out on decedent's life by two trusts created by decedent for this purpose in conjunction with decedent's contemporaneous purchase of a single premium nonrefundable annuity, without which the life insurance policies would not have been issued, are includible, for federal estate tax purposes, in decedent's gross estate under Section 2039 of the Internal Revenue Code of 1954.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 2039. ANNUITIES.

(a) *General.*—The gross estate shall include the value of an annuity or other payment receivable by any beneficiary by reason of surviving the decedent under any form of contract or agreement entered into after March 3, 1931 (other than as insurance under policies on the life of the decedent), if, under such contract or agreement, an annuity or other payment was payable to the decedent, or the decedent possessed the right to receive such annuity or payment, either

alone or in conjunction with another for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death.

(b) *Amount Includible.*—Subsection (a) shall apply to only such part of the value of the annuity or other payment receivable under such contract or agreement as is proportionate to that part of the purchase price therefor contributed by the decedent. For purposes of this section, any contribution by the decedent's employer or former employer to the purchase price of such contract or agreement (whether or not to an employee's trust or fund forming part of a pension, annuity, retirement, bonus or profit sharing plan) shall be considered to be contributed by the decedent if made by reason of his employment.

* * * *

Treasury Regulations on Estate Tax (1954 Code) (26 C.F.R.):

§ 20.2039-1 *Annuities.*

* * * *

(b) *Agreements or plans to which section 2039(a) and (b) applies.* (1) Section 2039(a) and (b) applies to the value of an annuity or other payment receivable by any beneficiary under any form of contract or agreement entered into after March 3, 1931, under which—

(i) An annuity or other payment was payable to the decedent, either alone or in conjunction with another person or persons, for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death, or

(ii) The decedent possessed, for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death, the right to receive such an annuity or other payment, either alone or in conjunction with another person or persons.

The term "annuity or other payment" as used with respect to both the decedent and the beneficiary has reference to one or more payments extending over any period of time. The payments may be equal or unequal, conditional or unconditional, periodic or sporadic. The term "contract or agreement" includes any arrangement, understanding or plan, or any combination of arrangements, understandings or plans arising by reason of the decedent's employment. * * *

* * * *

STATEMENT

At the time the transactions involved in this case were effected (early May of 1964), decedent, Lafayette Montgomery, was approaching his seventy-fifth birthday and was in extremely poor health, suffering from a variety of medical conditions, the most serious of which was severe pulmonary insufficiency resulting from advanced emphysema and chronic bronchitis. (Pet. 2a.)

On May 4, 1964, decedent executed instruments creating two irrevocable trusts for the benefit of his grandchildren. On the following day, the respective trustees of each of the trusts made application to the National Life Insurance Company (National) for life insurance on decedent's life in the amount of

$1,000,000 for each trust. On the same date, decedent made application to National for a nonrefundable life annuity payable to himself at the rate of $22,682 a month during his life in consideration of a single premium of $2,200,000. On the following day, May 6, 1964, National issued an annuity contract to decedent pursuant to these terms, and also issued two life insurance policies to the trusts, in the face amount of $1,000,000 each. On May 8, 1964, decedent borrowed sufficient funds to pay the $2,200,000 premium on the annuity and to fund each trust with the amounts required to pay the first annual premium of $132,938 on each life insurance policy. (Pet. 3a.)

No proof of decedent's insurability was presented to National. Since decedent was then in fact uninsurable at standard rates, National would not have issued the life insurance policies without the purchase of the life annuity on decedent's life, the effect of which was to offset any insurance risks to National under the life insurance policies. National regularly offered combination plans of this nature, whereby life insurance policies would be issued without proof of insurability so long as a nonrefundable annuity on the prospective insured's life was also purchased, as in this case, for a premium equal to 110 percent of the face value of the life insurance policies. (Pet. 3a-4a.)

Decedent died approximately six months later on October 31, 1964, after having received five monthly annuity payments from National. Each of the trusts

thereafter received $1,066,469 from National under the life insurance policies. (The excess over the face amount of each policy reflected a refund of one half of the first annual premium.) (Pet. 4a.)

The Commissioner determined that the proceeds of the two policies are includible in decedent's gross estate under both Section 2039 (relating to annuities) and Section 2035 (relating to transactions in contemplation of death) of the Internal Revenue Code of 1954. Taxpayer conceded (see court of appeals brief, p. 6) that the amounts transferred by decedent to the trusts to pay the policy premiums are includible as transfers in contemplation of death. The Tax Court held the proceeds includible in decedent's gross estate under Section 2039 without reaching the question whether they are also includible under Section 2035. The court of appeals affirmed. (Pet. 5a-6a.)

ARGUMENT

The decision below is correct and is consistent with the decisions of this Court. There is no conflict of circuits or other ground for further review.

The Tax Court and court of appeals correctly decided that Section 2039 of the Internal Revenue Code of 1954, *supra*, pp. 2-3 (relating to annuities), effectively thwarts decedent's rather transparent attempt to utilize an annuity-life insurance combination plan to divert $2,000,000 from his taxable estate to the objects of his bounty (his grandchildren) through

the intermediary of an insurance company.[2] The decisions below are not, as petitioner contends (Pet. 7-14), contrary to this Court's decision in *Fidelity-Phila. Trust Co.* v. *Smith*, 356 U.S. 274. In *Fidelity-Phila.*, the decedent acquired an annuity-life insurance combination long before his death and had assigned the life insurance portion thereof to the policy beneficiaries. The Commissioner attempted to bring the insurance policy proceeds paid on decedent's death within decedent's gross estate under Section 811(c) of the Internal Revenue Code of 1939 on the theory that the annuity represented a retained life income interest in the combination. This Court agreed that the purchase represented a single investment, but concluded that the transfer of the policies did not fall within Section 811(c), since the investment consisted of separate items of property and decedent retained no interest in the property (i.e., the policies) transferred to the beneficiaries. The instant case, however, arises not under Section 2036 of the 1954 Code (the successor to the provisions of Section 811(c) of the 1939 Code involved in *Fidelity-Phila.*), but under the different, substantially broader language of Section 2039 of the 1954 Code, which has no counterpart in the 1939 Code. Thus, both the Tax Court (R. 151-152; 56 T.C., pp. 496-497) and the court of appeals (Pet. 2a, n. 1) correctly noted that

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[2] Although neither court below ruled on the question, the Commissioner also contends that the transactions fall within the scope of Section 2035 (relating to transactions in contemplation of death). See *Bel* v. *United States*, 452 F. 2d 683 (C.A. 5), certiorari denied, May 15, 1972.

neither the holding nor the rationale of that case is controlling here.[3]

Section 2039 broadly prescribes the inclusion in the decedent's gross estate of "the value of an annuity or other payment receivable by any beneficiary by reason of surviving the decedent under *any form of contract or agreement* * * * if, under such contract or agreement, an annuity or other payment was payable to the decedent * * * for his life * * *."[4] (Emphasis added.) Nothing in this statutory language indicates that decedent must have had any control or legal interest in the survivorship benefits in order to bring the value of the survivorship rights into decedent's estate. See *Gray* v. *United States*, 410 F. 2d 1094, 1110 (C.A. 3). Thus, the care taken by decedent to ensure that he never had any inci-

[3] Indeed, even if this case had arisen under Section 2036, it is doubtful whether *Fidelity-Phila.* would be controlling, since here decedent was uninsurable at the standard rates at which the policies were purchased, and thus the value of the policies issued to the trusts was created substantially by decedent's investment in the annuity. Unlike the apparent facts in *Fidelity-Phila.*, something far more substantial than the cost of the premiums was transferred to the trustees by decedent in this case.

[4] Excluded from the coverage of this section are amounts received "as insurance under policies on the life of the decedent," the includibility of which is governed by Section 2042. It has been settled since *Helvering* v. *Le Gierse*, 312 U.S. 531, however, that the term "life insurance" as used in the federal estate tax statutes does not include policies issued pursuant to annuity-life insurance combination plans, such as that involved in this case, which involve no true insurance element of risk shifting and risk distribution

dents of ownership in the policies is essentially irrelevant under Section 2039. Compare Section 2042 (2) of the Internal Revenue Code of 1954.

Nor is the statutory phrase "any form of contract or agreement" so inflexible as to permit the circumvention of Section 2039 by the simple expedient of evidencing the respective rights of the insured-annuitant and the insurance beneficiaries in separately issued policies, rather than in a single combination policy. Section 20.2039-1(b) of the Treasury Regulations on Estate Tax, *supra*, pp. 3-4, specifically provides that "the term 'contract or agreement' includes any arrangement, understanding or plan, or any combination of arrangements, understandings or plans arising by reason of the decedent's employment," and the courts which have dealt with the question have uniformly held that such combinations are encompassed by Section 2039. See *Gray* v. *United States, supra; All* v. *McCobb*, 321 F. 2d 633 (C.A. 2); *Bahen's Estate* v. *United States*, 305 F. 2d 827 (Ct. Cl.). Petitioner contends (Pet. 14) that this principle applies only to understandings arising by reason of decedent's employment. Even if the Regulations might be read in this narrow manner, which we think they cannot, there is no basis in reason or in the language of the statute, which applies equally to private contracts between individuals and insurance companies and to employee survivorship and retirement plans, which would support a distinction in the treatment of these two situations.

Finally, petitioner asserts (Pet. 5-7) that the Tax Court was foreclosed by the stipulation of facts from inferring that the various stipulated transactions were, in fact, part of an integrated step transaction entered into pursuant to an understanding and agreement among National, the decedent and the trustees. But this Court's opinion in *Commissioner* v. *Duberstein*, 363 U.S. 278, 291, makes it clear that it is the responsibility of the fact finder to make ultimate factual inferences from undisputed basic facts, and nothing in the stipulation in this case is in any way contrary to the Tax Court's finding of an integrated, prearranged step transaction. Indeed, we submit that any other inference is inconceivable. Clearly, National would not have issued and the trustees could not have acquired the life insurance without the concomitant purchase of the annuity. Moreover, in light of his state of health, it is extremely unlikely that decedent would have purchased the annuity without National's commitment to issue the life insurance policies. Furthermore, the trusts had no means to acquire any assets, except insofar as decedent funded them *after* the insurance applications had been approved by National.

We find, and petitioner cites, no other decision of any court of appeals which involves the same question as to the applicability of Section 2039 to similar life insurance-annuity combinations. The decisions of the Second and Third Circuits and the Court of Claims, in *All* v. *McCobb*, *Gray* and *Bahen's Estate*, *supra*, involving the analogous question of the appli-

cability of Section 2039 to combinations of survivor benefit and pension plans arising by reason of employment, are in accord with the decision below. Thus, there is no conflict of decisions which would warrant further review by this Court.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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